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E. ROBERT SEAVER

IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

No. 71-1059

KERN COUNTY LAND COMPANY,
Petitioner,

v.

OCCIDENTAL PETROLEUM CORPORATION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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February 17, 1972.

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Petitioner, the present Kern County Land Company ("New Kern"), prays that a writ of certiorari issue to review a decision of the United States Court of Appeals for the Second Circuit. In an action under Section 16(b) of the Securities Exchange Act of 1934, the court of appeals (a) reversed the district court's entry of summary judgment against defendant Occidental Petroleum Corporation ("Occidental") in the amount of $23,511,337.94, representing profits (including dividends) and interest realized by Occidental in the purchase and disposition of a more than 20% interest in the common stock of petitioner's predecessor, the former Kern County Land Company ("Old Kern"), and (b) instead remanded with instructions to

enter judgment dismissing the complaint, although such relief had not been sought by Occidental below.

Opinions Below

The decision of the court of appeals of which review is sought is reported at 450 F.2d 157 (1A)*. The decision of the district court which was reversed by the court of appeals is reported at 323 F. Supp. 570 (1C).

Jurisdiction

The judgment of the Court of Appeals for the Second Circuit was entered on October 13, 1971 (1B). A timely petition for rehearing or, in the alternative, rehearing in banc was filed on October 27, 1971. Such petition was denied on November 19, 1971 with Judge Hays noting his dissent from the denial of rehearing in banc (3B, 4B). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

Questions Presented

1. Whether a statutory insider's sale of an option with respect to over 20% of a class of securities, in return for an $8,866,230 cash payment, within a month after it had purchased such securities, is a "sale" of such securities under Section 16(b)?

2. Whether a statutory insider's exchange of a more than 20% interest in a class of securities for securities of an entirely different company, at a profit to the insider of some $18 million, less than six months after such securities had been purchased in a cash tender offer, is a "sale" of such securities under Section 16(b)?

* Citations with the suffix "A" "B" or "C" are to pages of the Appendix hereto.

Statute Involved

Section 3(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a), provides in pertinent part:

> "When used in this chapter, unless the context otherwise requires—
>
> • • • • •
>
> "(14) The terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of."

Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78p(b), provides in pertinent part:

> "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner,* director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months • • • shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. • • • This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

* The term "such beneficial owner" relates back to Section 16(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78p(a), which provides for the reporting of beneficial ownership of equity securities and changes in such ownership by, among others, "[e]very person who is directly or indirectly the beneficial owner of more than 10 percentum of any class of any equity security (other than an exempted security) which is registered pursuant to section 12" of the Securities Exchange Act of 1934, 15 U.S.C. 78*l*. The Old Kern securities involved in this action were so registered.

The Facts

Occidental's Purchase of Old Kern Shares

On Monday, May 8, 1967, Occidental publicly announced that it was making a cash tender offer to purchase up to 500,000 shares (an amount in excess of 10% of those outstanding) of Old Kern common stock at $83.50 per share. By May 10, 1967, two days after Occidental's tender offer was first announced, more than 500,000 shares of Old Kern stock had been tendered to Occidental (450a-1, 764a*), and on May 11, 1967, Occidental announced an amendment of its tender offer to cover an additional 500,000 shares (452a). Prior to the close of its offer on June 8, 1967, Occidental purchased a total of 885,649 shares as a result thereof (over 20% of those outstanding) at a total cost of $75,280,165 (407a, 1075a).

The Tenneco-Old Kern Agreement

Following Occidental's announcement of its tender offer, Old Kern's management entered into discussions with various companies, including Tenneco Inc. ("Tenneco") and Occidental itself, with a view to possible corporate combination (645a). On May 19, 1967, Old Kern's Board of Directors approved an offer by Tenneco under which Tenneco was to acquire Old Kern's business and assets in exchange for shares of a new Tenneco Convertible Preference Stock to be distributed to Old Kern shareholders in exchange for their Old Kern common stock. Old Kern's acceptance of the Tenneco offer was announced the same day (641a-649a). Occidental appraised the Tenneco stock at $105 per share and its President, Dr. Armand Hammer issued a statement dated the same day, Friday, May 19, 1967, to Occidental stockholders announcing an indicated

* Citations with the suffix "a" are to pages of the Joint Appendix filed with the court of appeals, a certified copy of which has been filed in this Court.

"profit to your company of about $18 million . . ." (710a, pp. 6-7).

The Occidental Option Agreement

On the following Monday, May 22, 1967, Occidental made written demand upon Old Kern for an inspection of its list of shareholders, books of account, minutes of stockholder, board of directors and executive committee meetings, together with all records, books and documents referred to therein (668a). On Thursday, May 25, 1967, Occidental filed a petition in the California Superior Court demanding inspection of such documents (849a).

Prior to the return date of its petition, Occidental, describing itself as "the principal stockholder of Kern County Land Company", made a further written demand upon Old Kern calling for inspection of numerous additional books and records, as well as "the election of at least two (2) persons to be designated by Occidental to the board of directors" (671a). This demand was followed by the filing of a second court petition on May 31, 1967, alleging Occidental's status as owner of more than 10% of Old Kern's common stock and asserting that it needed such inspection in order to determine whether or not "to oppose" the Tenneco-Old Kern transaction, citing the time needed "to prepare proxy soliciting material" and to "file preliminary copies of such proxy soliciting material with the Securities and Exchange Commission" (858a, 861a). Prior to any court ruling on Occidental's petitions, Old Kern voluntarily permitted a team of up to five Occidental lawyers and accountants to inspect Old Kern's general ledger, consolidated financial statements, consolidating journal entries, details of cash receipts from oil operations, supporting trial balances and other records over a six-day period (650a).

In the interim, on May 23, 1967, Occidental's Executive Vice President, Mr. Walter R. Davis, requested a meeting

with Mr. Gardiner Symonds, then Chairman of the Board and chief executive officer of Tenneco (584a). This meeting took place on May 30, 1967, the Memorial Day holiday, at Mr. Symonds' home in Houston, Texas. According to Mr. Davis' deposition testimony:

> "I went in and after just miscellaneous conversation, I told Mr. Symonds that I felt like Occidental did not want to get into a proxy fight with Tenneco or a fight in the Kern County situation and that I had been authorized by Dr. Hammer to discuss with him the possible purchase of our stock . . ." (Davis Dep., pp. 32-33).

The initial meeting between Mr. Davis and Mr. Symonds was followed by meetings between them in New York on June 1 and 2, 1967, at which the parties were also represented by counsel. At these meetings, Occidental's attorneys proposed that the parties enter into an option agreement exercisable after December 9, 1967 (six months plus one day after the closing date of Occidental's tender offer), giving Tenneco an option to purchase at $105 per share 886,623 shares of Tenneco Preference Stock which Occidental would receive in exchange for its Old Kern common stock upon consummation of the Tenneco-Old Kern agreement (585a). The cost of this option was to be $10 per share, or a total of $8,866,230 to be credited against the aggregate purchase price of $93,095,415 upon exercise of the option. A formal written option agreement between Occidental and Tenneco Corporation (a subsidiary of Tenneco Inc.) was prepared. It provided that, if the closing of the Tenneco-Old Kern agreement did occur, Occidental would retain the $8,866,230 which it had received even though Tenneco failed to exercise its option (461a, *et seq.*).

On Friday, June 2, 1967, the Option Agreement was executed on behalf of Tenneco and Occidental. On the same day, Occidental publicly announced that it would not oppose Tenneco's proposed acquisition of Old Kern (712a-713a),

and gave its attorney, Mr. Albert J. Brown, of the San Francisco firm of Pillsbury, Madison & Sutro, a proxy to vote its Old Kern shares specifically authorizing him "to vote in favor of the proposed sale of the assets of Kern County Land Company to a wholly-owned subsidiary of Tenneco Inc." Mr. Brown in turn assured Tenneco's counsel that he would vote Occidental's Old Kern shares in favor of the Tenneco acquisition.* Occidental also thereafter voluntarily dismissed its pending legal actions for production of Old Kern books and records (700a, 709a), and abandoned its demand for seats on Old Kern's Board.

Upon the execution of the Option Agreement on June 2, 1967, Tenneco paid Occidental $886,623 by check and a week later transmitted the rest of the total $8,866,230 option price (416a).

Occidental's Efforts to Secure an SEC Rule

On the Monday following execution of the Option Agreement, June 5, 1967, Occidental's attorneys sent Tenneco's counsel a copy of a proposed Rule 16(b)-11 which Occidental had asked the Securities and Exchange Commission to adopt (433a, 512a). This proposed rule would have exempted from the operation of Section 16(b) the "disposition . . . pursuant to a merger or consolidation" of securities by a beneficial owner of more than 10%, provided the beneficial owner (a) had acquired them in a public tender offer and (b) continued to hold the security acquired by him in the merger more than six months after his purchase of the original security (512a).** The next day, June 6,

* The foregoing proxy and Mr. Brown's assurances were not part of the record before the district court and the court of appeals, but were brought to the court of appeals' attention by the petition for rehearing which pointed out that discovery below had not been completed and that there were additional facts which could be elicited at a trial and which precluded the grant of summary judgment in favor of Occidental.

** The language of the exemption urged upon the Commission by Occidental concedes that a disposition of securities in a merger or sale of assets is a "sale" under Section 16(b).

1967, Occidental's counsel, Mr. Brown, wrote to Tenneco's counsel concerning the proposed rule (571a-572a). Mr. Brown's letter referred to a telephone conversation he had had the previous day with Mr. Philip Loomis, then General Counsel of the Securities and Exchange Commission, "to discuss the proposed rule that the SEC was considering to give Occidental some relief in the situation in which it found itself". Mr. Brown stated:

> "As we had proposed the rule and, as we had understood from Myer Feldman [Occidental's Washington counsel], we were going to be granted an exemption at both ends."

Mr. Brown's letter further noted that if a rule were not adopted, the "only alternative" Occidental would have would be "to commence every kind of litigation it could reasonably bring and attempt to stall the consummation of the Tenneco-Kern transaction for six months".* Mr. Brown noted that "[o]bviously this would be disadvantageous to the other Kern stockholders".

On July 12, 1967, the Commission advised Occidental's counsel that "the Commission considers it undesirable to publish for comment any proposed rule in this area at the present time" (523a). Occidental persisted in its efforts to obtain a rule from the Commission and on August 29, 1967 the full Commission heard argument in support of a modified and more restricted version of Occidental's proposed rule (435a, 531a) and later considered a 30-page letter from Occidental's counsel in further support of its proposed rule (534a). Nevertheless, the Commission refused to

* A whole series of purported stockholder suits attempting to block the Tenneco-Old Kern transaction did subsequently materialize. These are reviewed in detail in the opinion of the District Court for the Northern District of Texas in *600 California Corp.* v. *Harjean Co.*, 284 F.Supp. 843 (N.D. Tex. 1968), in which the court concluded that "somebody with a lot more at stake and a much stronger motive for delaying the closing than these named plaintiffs was furnishing an almost unlimited expense account to finance this weird pattern of delaying actions." (284 F.Supp. at 861.)

modify its earlier decision not to take action and no such rule was ever adopted.

The Closing of the Tenneco-Old Kern Transaction

Tenneco's acquisition of the business and assets of Old Kern was embodied in a formal Agreement and Plan of Reorganization between Tenneco, Old Kern and New Kern (a newly organized Delaware corporation formed by Tenneco to receive the business and assets of Old Kern) (456a). This Agreement, which provided for the exchange of Tenneco Preference Stock for Old Kern common stock by Old Kern shareholders, was approved by the Old Kern shareholders at a meeting held on July 17, 1967.

On August 30, 1967, the closing of the Tenneco-Old Kern agreement was held. Old Kern transferred its assets and business to New Kern and received shares of Tenneco Preference Stock, which it deposited with the Exchange Agent "with irrevocable instructions for distribution of such shares to the Kern shareowners upon receipt of their Kern stock certificates for cancellation" (485a). Thereupon, Old Kern's stockholders, including Occidental, ceased to own any interest in Old Kern as an independent operating company, and their Old Kern stock certificates became evidence only of their beneficial ownership of shares of Tenneco Preference Stock (410a-411a). On October 6, 1967, Old Kern was formally dissolved pursuant to California law (413a-414a).

On December 11, 1967, a closing was held under the Option Agreement in Nassau, Bahamas, at which time $84,229,185 was credited to Occidental's accounts at various banks. With this amount, plus the $8,866,230 which had been paid to it in June, Occidental received $93,095,415 with respect to its Old Kern stock (414a). With respect to the 885,649 shares purchased pursuant to its tender offer, this represented a $17,712,980 profit (421a). In addition, Occidental

received two dividends totaling $1,797,124.23, which, when added to the $17,712,980 profit realized on Occidental's sale of stock, come to a total profit of $19,506,419.22 realized by Occidental by reason of its acquisition and disposition of its 20% beneficial interest in Old Kern (415a).

The Proceedings Below

In October 1967, following the institution of two actions on behalf of Old Kern stockholders, New Kern, as assignee of Old Kern, filed this action pursuant to Section 16(b) for recovery by it of Occidental's short-swing profits. These actions, and a third Old Kern stockholder action subsequently instituted, were consolidated for purposes of pretrial discovery. 44 F.R.D. 543 (S.D.N.Y. 1968).

Following certain limited discovery directed to establishing the grounds for a summary judgment motion by plaintiffs, New Kern moved for summary judgment on the basis of the undisputed facts elicited thus far. Such motion was granted by the district court. On appeal, the court of appeals not only reversed the judgment below but further directed entry of judgment in favor of Occidental.

Reasons for Granting the Writ

The reversal by the court of appeals of the district court's judgment against Occidental in the amount of $23,511,337.94, with instructions to dismiss the complaint (relief not even sought by the defendant in the district court), leaves intact Occidental's admitted profit of some $18 million, exclusive of dividends and interest, derived from its purchase and subsequent disposition of a more than 20% beneficial interest in the common stock of Old Kern. To reach such result, the court of appeals ignored the "mechanical quality" of the statute (*Reliance Electric*

Co. v. *Emerson Electric Co.*, U.S. (1972), Slip Op., p. 7) and defined the statutory term "sale" narrowly so as to exclude not only Occidental's sale of an option but also the subsequent exchange of Old Kern shares for Tenneco shares—both of which events occurred less than four months after Occidental purchased over 20% of Old Kern's common stock.

By holding that the sale of an option is not a "sale" under Section 16(b), the court of appeals opens up a new method of evasion, the option device, to any insider, be he officer, director or beneficial owner, who wishes to make short-swing profits without forfeiting those profits in a Section 16(b) action. Such holding is in conflict with a recent decision of the Court of Appeals for the Seventh Circuit, *Bershad* v. *McDonough*, 428 F.2d 693 (7th Cir. (1970), *cert. denied*, 400 U.S. 992 (1971), a decision recently cited with approval by this Court in the *Reliance* case.

Secondly, in further holding that, under the particular circumstances presented, the exchange of Old Kern securities for Tenneco securities was not a "sale" under Section 16(b) (the first occasion on which any court has ever held that an exchange of the securities of one company for those of an entirely separate and distinct company did not constitute a "sale" under Section 16(b)), the court of appeals opened up a further avenue for the realization of short-swing profits, particularly significant in the tender offer situation. If not corrected by this Court, the holding below will undoubtedly control pending and future litigation in this important area of federal concern.*

* A district court decision filed October 12, 1971, the day before the court of appeals' decision here, holding that an exchange of stock was a "sale" and finding the unsuccessful tender offeror liable under Section 16(b) in an almost identical situation, was withdrawn on October 15, 1971 in view of the decision here. *American Standard, Inc.* v. *Crane Co.*, CCH Fed. Sec.L.Rep. ¶ 93,237 (S.D.N.Y.).

I.

The Occidental "option" was a "sale" under Section 16(b).

Although "recognizing that, under the statutory definition, §3(a)(14) [of the 1934 Act], 'sale' includes 'contract to sell'" and that "an option entitling the optionee to purchase is a contract to sell in a dictionary sense", the court of appeals nevertheless held it to be the rule "in this circuit" that the "mere grant of an option to purchase is not a sale for purposes of §16(b)" and that a sale "occurs only when the optionee exercises the option" (13A).

In formulating such a rule, the court of appeals did not undertake any examination of the speculative possibilities inherent in an insider's short-swing sale of an option. In failing to make such inquiry, the court ignored long established criteria for the construction of Section 16(b). As this Court recently noted in *Reliance Electric Co.* v. *Emerson Electric Co., supra.*:

> "In interpreting the terms 'purchase' and 'sale', courts have properly asked whether the particular type of transaction involved is one that gives rise to speculative abuse. See, *e.g., Bershad* v. *McDonough,* 428 F. 2d 693 (CA7 1970) (granting of an option to purchase constitutes a 'sale'). (Slip Op. 7 fn.)

In the *Bershad* case, in contrast to the holding of the court of appeals here that the "mere grant of an option to purchase is not a sale for purposes of §16(b)" and that a sale occurs "only when the optionee exercises the option" (13A), the Court of Appeals for the Seventh Circuit analyzed the speculative possibilities inherent in an insider's sale of an option and concluded:

> "The insider's sale of options in his stock is well adapted to speculation and abuse of inside informa-

tion *whether or not the option is subsequently exercised.* The sale of the right to purchase the underlying security is itself a means of realizing a profit from that security. The right to purchase stock at a given price under specified circumstances, although clearly not identical to the rights attendant upon ownership of the stock itself, derives from and is dependent upon the value of the underlying security. *Sale of such purchase rights provides an easy vehicle for the use of inside information in extracting profits from the stock itself."* (Emphasis added) (428 F.2d at 698)

The opinion below attempted to confine the *Bershad* decision to its alternative holding that the facts there were sufficient to characterize the option as a disguised sale, and concluded that there is "no conflict between *Bershad* and what we rule here, although we would not be understood as necessarily agreeing with everything said in the court's opinion" (15A). This treatment of *Bershad* ignores the fact that the Court of Appeals for the Seventh Circuit held in the first instance that the sale of an option, *qua option,* is a device "well adapted to speculation and abuse of inside information" and may thus be a "sale" of the underlying security within the meaning of Section 16(b). It further ignores, as was demonstrated in New Kern's Petition for Rehearing, the factual identity of the two cases.

In the *Bershad* case, the defendants purchased approximately 18% of the outstanding shares of Cudahy Company common stock on March 15 and 16, 1967 at $6.75 per share. Some four months later defendants entered into an option agreement under which they were obligated to sell the bulk of these shares at $9 per share on or before October 1, 1967; the optionee paid $350,000 (14% of the purchase price) for the option to be applied against the purchase price in the event of exercise and, in the event of non-exercise, to be

retained by the defendants. At the same time, the defendants gave the purchaser a proxy with respect to the optioned stock, irrevocable until October 1, 1967. Defendant McDonough and his colleagues then resigned as Cudahy directors in favor of nominees of the option purchaser. The purchaser indicated its intention to exercise the option on September 22, 1967, six months and six days after defendants' purchase, and the shares were delivered five days later. On these facts the Seventh Circuit, affirming a grant of summary judgment to plaintiff, concluded that "the stock was effectively transferred, for all practical purposes, long before the exercise of the option" (428 F.2d at 698).

In the present case, the option price amounted to almost $9 million (25 times the amount in *Bershad*), was nearly 10% of the total $93,095,415 purchase price, was to be applied to the purchase price upon exercise of the option, and was to be forfeited if the option were not exercised, leaving little if any possibility of non-exercise. The execution of the option was also accompanied by the giving of a proxy to Occidental's attorney in which he was "specifically authorized" to vote in favor of Tenneco's acquisition of Old Kern and by his assurance to Tenneco, in turn, that the Occidental proxy would be so voted. While there was no resignation of directors (Occidental had no representatives on the Old Kern board), Occidental's pending demand for two seats on Old Kern's board was abandoned, as was its pending litigation for inspection of Old Kern's books and records. In short, the Occidental "option" was in fact just as much a sale as of the date it was entered into as the "option" in the *Bershad* case. However, while the Court of Appeals for the Seventh Circuit affirmed a grant of summary judgment against the defendant, the court of appeals here directed summary judgment in favor of defendant

Occidental, although such relief had not even been sought below.*

The court of appeals' opinion here gives every insider, be he a 10% beneficial owner, officer or director, an "escape hatch" from the strict and uncompromising limitations imposed upon him by Section 16(b). The opinion leaves him free to purchase stock and to reap a short-swing speculative profit upon it by selling an option at a price and upon terms which reflect his access to inside information. As a result of the court of appeals' decision here, there is every reason to expect that insiders (unless they are in the Seventh Circuit) will resort to the option device with increasing frequency as a means for realizing speculative profits.

Granted, the insider selling an option need not necessarily reap the same profit that he would realize from an outright sale, but this is no reason for freeing him from

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* Occidental asked the district court "to deny plaintiffs' motions for summary judgment pending a full trial on the merits" (721a). On its appeal, Occidental asserted in one sentence of its 122-page brief that the district court "should have granted summary judgment to Occidental or proceeded to trial on the merits", noting in a footnote that the court had power to grant judgment in its favor despite Occidental's failure to move for such relief. The point was not pressed and petitioner made no response to it since it did not appear to be seriously urged. Although the court of appeals' opinion asserts that "inquiry at the argument failed to reveal any new facts that might be adduced by them [petitioner] at an evidentiary hearing", none of petitioner's counsel present at the argument recall any inquiry as to what further facts they might adduce at a hearing. In granting summary judgment in Occidental's favor, and thereby resolving in its favor the question of whether or not the option was "in truth and fact a sale" (14A), the court of appeals disregarded its own admonition in *Schoenbaum* v. *Firstbrook*, 405 F.2d 215, 218 (2d Cir. 1968), *cert. denied*, 395 U.S. 906 (1969), against the granting of summary judgment for defendant in stockholder actions where often "there will be issues as to the knowledge, intent and motive which will require a full trial with an opportunity to observe the demeanor of the witnesses, and to conduct cross-examination in open court" (citing this Court in *Poller* v. *CBS*, 368 U.S. 464 (1962)).

Section 16(b) liability. Noting this possibility, the Court of Appeals for the Seventh Circuit stated in its *Bershad* opinion:

> "[T]he possible distinctions do not indicate that the insider here may not speculate with the special information he acquires, but only that his ability to maximize his profits from such utilization of inside information is somewhat diminished." (428 F.2d at 698 fn.)

Here, in contrast, the Court of Appeals seemed to feel that the mere possibility of non-exercise of the option was enough to exempt it from being a "sale" for Section 16(b) purposes. In fact, the option here was indeed exercised at a profit to Occidental of nearly $18 million. Moreover, this reasoning ignores the fact that non-exercise (assuming there was any realistic possibility of it) would have left Occidental with a nearly $9 million profit by reason of the option price alone, which profit should certainly be subject to recovery in a Section 16(b) suit.

II.

Alternatively, the Exchange of Kern Shares for Those of Tenneco Was a "Sale" Under Section 16(b)

Apart from its holding with respect to the option, the court of appeals further held that the August 30, 1967 exchange of Old Kern shares for Tenneco shares (which occurred less than four months after Occidental's purchase of its 20% interest in Old Kern) was not a "sale" by Occidental under Section 16(b). In this respect, the court of appeals promulgated an exemptive rule for tender offerors which, ironically, is far broader than the restricted tender

offer rule which Occidental urged so vigorously (and unsuccessfully) upon the SEC in the summer of 1967.*

The opinion below notes that this case "raises important questions with respect to the problems under §16(b) of the Securities Exchange Act that may be encountered by the maker of a tender offer who finds himself outflanked by a 'defensive merger'. . . ." The court of appeals resolves those questions by expressing doubt over the "equity" of depriving the defeated tender offeror of its short-swing profits and by expressing concern that imposition of Section 16(b) liability "would operate to discourage tender offers for more than 10% of a company's stock" (13A).

Such concern and solicitude for the defeated tender offeror is in sharp contrast to the views expressed by the then Chairman of the Securities and Exchange Commission in hearings before the House Committee on Interstate and Foreign Commerce, 90th Cong., 2d Sess. (on H.R. 14475 and S. 510, at p. 22, July 1, 1968).** Noting the inherent possibilities of speculative abuse and profits in the tender offer situation the Chairman testified:

> "There has been enough experience in the past 2 years for any sophisticated takeover bidder to know that, unless management joins him, management will seek another partner and that other partner probably will make a slightly better offer. We have the feeling that many of these people are doing it for the short-term gain, or, to use the vernacular, to make a fast buck. We have a number of variants of that. We have a situation where almost overnight

* The court of appeals speculates that the "Commission may have thought the rule unnecessary or undraftable" or "the time inappropriate" (6A fn.). The court does not refer to the equally real possibility that the Commission thought such a rule would be contrary to the purposes of Section 16(b).

** The court of appeals did not ask the Commission for a brief setting forth its views with respect to the issues presented by the appeal.

> [a] particular individual or company made several millions of dollars in a situation of this kind.
>
> "We have the feeling that some of these offers are made only to initiate that activity."

In giving the above testimony, the Chairman could well have had Occidental in mind. As an article on tender offers, in the August 1967 issue of Fortune states:

> "[W]hile Occidental failed to win control of Kern, it could look forward to a gross capital gain of more than $17 million on the Kern shares it had acquired. 'That', Armand Hammer [Occidental's President] observes, 'isn't bad for two weeks' work.'" (p. 109)

In the recent *Reliance Electric Co.* v. *Emerson Electric Co.* case, *supra*, Emerson, given the decision of the court of appeals here, would not have felt it necessary to dispose of any of its Dodge holdings prior to Reliance Electric's merger with Dodge. As this Court noted in its opinion, Emerson, which like Occidental had acquired its stock position in a cash tender offer, had encountered "certain failure" in its efforts to take over Dodge and was faced "with the prospect of being forced to exchange its Dodge shares for stock in the merged corporation in the near future". Emerson wanted to "immunize" a portion of those shares from liability under Section 16(b). Its concern about Section 16(b) liability was understandable. As this Court noted in a footnote to its opinion:

> "The Court of Appeals for the Second Circuit has held that an exchange of shares in one corporation for those of another pursuant to a merger agreement constitutes a 'sale' within the meaning of § 16(b). *Newmark* v. *RKO General, Inc.*, 425 F.2d 348, 354 (CA2 1970)." (Slip Op., p. 2)

Now, however, given the opinion here, Emerson would have no cause for concern, since the court of appeals exempts

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the insider in Emerson's situation from the rule set forth in the *Newmark* case.

In this holding, the court of appeals again, as in its holding with respect to the sale of the option by Occidental, bent over backwards to restrict the statutory term "sale" to what it characterized as the "garden-variety" cash sale (8A), holding that the acquisition of 20% of a class of common stock in a cash tender offer followed by the exchange of that stock less than six months later for shares of an entirely different company (at an $18 million profit) presents no possibility of speculative abuse, thereby excluding the exchange from the statutory term "sale".

In so doing, the court of appeals takes it for granted that the losing contestant in a take-over effort cannot possibly reap a speculative profit, drawing upon particular facets of the Occidental tender offer. Such an *ad hoc* approach ignores the possibilities for speculative abuse inherent in any situation where two companies propose to merge and a large recently-acquired dissident block of stock is outstanding in one of them. Aside from his statutorily presumed access to inside information, the insider holding such a block can use his stock position to make a profitable arrangement, not available to other shareholders, for himself. This is exactly what Occidental did here in carrying forward its threats of a proxy fight, supported by legal demands and litigation (which enabled it to secure an extensive inspection of Old Kern's books and records), until it was able to secure a special (and very profitable) arrangement for itself in the form of the Option Agreement.

The court of appeals' treatment of the exchange of securities raises a further question of general importance to the future application of Section 16(b): Whether the courts may grant *ad hoc* exemptions from Section 16(b) in cases involving so-called "unusual" transactions. Aside from a few exceptions set forth in the statute, Section 16(b) mandates recovery from an insider of any profit realized through the

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purchase and sale of equity securities of the relevant issuer within a six-month period, but provides that it shall not apply to "any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose" of Section 16(b). Thus, the statute clearly imposes a broad objective standard of liability, reserving to the Commission through rule-making proceedings of a legislative nature, and not to the courts in individual cases, the power to define types of transactions which should be exempt. This statutory scheme thus provides the possibility of relief for persons deserving it in "situations that Congress scarcely considered" (9A) without undermining the "mechanical quality" of the statute* by encouraging every insider to resist recovery and litigate in the hope of persuading a court, as here, that it would be "repugnant" to its "sense of equity" (13A) on the facts of the particular case to require recovery of profit realized in a non-cash transaction.**

Several courts have, of course, concluded that, considered in the light of the purpose of Section 16(b), certain types of transactions, "objectively defined", should not be considered to be "purchases" or "sales" within the meaning of Section 16(b). However, these decisions have been premised on the conclusion that there was no possibility of

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* *Reliance Electric Co.* v. *Emerson Electric Co., supra,* Slip Op., p. 7.

** One member of this court has written with respect to Section 16(b):

> "[I]f the Congress intended to provide additional exceptions, it would have done so in clear language; . . . the recognized purpose and aim of the statute are more consistently and protectively to be served if the statute is construed literally and objectively rather than non-literally and subjectively on a case-by-case application. The latter inevitably is a weakening process." *Petteys* v. *Butler,* 367 F.2d 528, 538 (8th Cir. 1966), *cert. denied,* 385 U.S. 1006 (1967) (Blackmun, J., dissenting).

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speculative abuse where the transaction did not involve a real change in the equity investment of the insider (which in fact was maintained for more than six months)* or where the transaction was one which did not result in a profit.** These decisions do not, as the court of appeals' opinion suggests (9A), constitute a "revolt" against the objective character of Section 16(b), but are simply determinations that, in situations of the type considered, a basic element of liability was absent, *i.e.*, an investment of less than six-months' duration in the issuer or realization of a profit, and that therefore the "transaction" was not one susceptible of "speculative abuse", *i.e.*, the realization of short-term profits by insiders, which Section 16(b) is designed to prevent.

No court has ever before held that Section 16(b) liability did not exist when, as in this case, an insider acquired and disposed of an equity investment in an issuer in less than six months and realized a substantial profit in the process. Unlike the conversion cases discussed above, where the courts were able to find that the intra-corporate exchange, standing by itself, presented no possibility of speculative abuse, the court of appeals here did not hold that the Old Kern-Tenneco exchange, standing by itself, could not lend itself to speculative abuse, but instead found that the particular facts, starting with Occidental's acquisition of its shares in a tender offer, showed no evidence of speculative

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* See, *e.g.*, *Ferraiolo* v. *Newman*, 259 F.2d 342 (6th Cir. 1958), *cert. denied*, 359 U.S. 927 (1959); *Blau* v. *Lamb*, 363 F.2d 507 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967) and *Petteys* v. *Butler*, *supra* (conversion of convertible security); *Blau* v. *Mission Corp.*, 212 F.2d 77 (2d Cir.), *cert. denied*, 347 U.S. 1016 (1954) (transfer to 100%-owned subsidiary); *Blau* v. *Max Factor & Co.*, 342 F.2d 304 (9th Cir.), *cert. denied*, 382 U.S. 892 (1965) (exchange of substantially identical classes of equity security).

** See, *e.g.*, *Shaw* v. *Dreyfus*, 172 F.2d 140 (2d Cir.), *cert. denied*, 337 U.S. 907 (1949) (private gift).

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abuse. Only by undertaking such an *ad hoc* examination of Occidental's situation (and by accepting without trial Occidental's protestations of innocence) was the court of appeals able to conclude that an exchange of securities of one company for those of a totally separate and distinct company was not a "sale" for purposes of Section 16(b). Prior to the decision below, no court had ever held that an exchange of securities in different companies was anything other than a "purchase" or "sale" of such securities.* (*Cf., SEC* v. *National Securities, Inc.*, 393 U.S. 453 (1969), holding in a Section 10(b) action that "shareholders 'purchased' shares in the new company by exchanging them for their old stock.")

The decision below represents an abrupt departure from existing law, carving out a judicial exemption for unsuccessful tender offerors which will have widespread impact and raising the possibility of creating other similar *ad hoc* exemptions. This is completely contrary to the statutory purpose underlying Section 16(b).

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* *Newmark* v. *RKO General, Inc., supra; Marquette Cement Mfg. Co.* v. *Andreas*, 239 F.Supp. 962 (S.D.N.Y. 1965); *Blau* v. *Hodgkinson*, 100 F.Supp. 361 (S.D.N.Y. 1951); *Gold* v. *Scurlock*, 324 F.Supp 211 (E.D. Va. 1971).

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CONCLUSION

For the reasons set forth above, the petition for a writ of certiorari should be granted and the judgment of the Court of Appeals for the Second Circuit reversed.

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